Note for the European Commission as input for the solidarity guidance according article 12 of Regulation 1938/2017

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A deliverable of the CEER Security of Supply Task Force

1 Background

This note sets out CEER's input for the solidarity guidance to be developed by the European Commission as provided in article 13 of the Revised Regulation of 1938/2017[1].

Since November 2014, CEER has actively participated in discussions to assist the European Commission in their work of revising Regulation (EU) No 994/2010[2] concerning measures to safeguard security of gas supply. Besides interventions at the Gas Coordination Group and the organisation of a CEER workshop on security of supply (5 September 2016), two papers have been produced by the CEER Security of Supply Task Force:

- CEER's response to the European Commission consultation document for the revision of Regulation (EU) No 994/2010[3];
- CEER's policy recommendations for the revision of Regulation (EU) No 994/2010.[4]

CEER endorses the nine principles of solidarity as summarized by the European Commission at the Gas Coordination Group meeting of 22 March 2017. These principles are in line with CEER views earlier expressed and are being used as reference for this note.

CEER underlines the importance of clarity that solidarity only kicks in after the market fails to offer additional gas for the concerned protected customers. This should be a fundamental principle of the guidance document. When solidarity kicks in, all gas supply contracts have been called upon or have been involuntary curtailed. There are no market means anymore to procure solidarity gas. The only way to provide gas to protected customers who face insufficient supply is by reallocation of gas contracted by non-protected customers in solidarity providing Member States. It should be recognised that in this severe situation, market functioning in the solidarity requesting Member State as well as likely in Europe more widely has failed and the relevant Member States are in a phase of forced curtailment. Before this phase, gas could still be procured within Europe (incl. voluntary demand side response) on a trading basis.

CEER provides guidelines mainly focussing on the organisation of a solidarity mechanism, the price setting mechanism for solidarity and the reallocation of gas volumes for solidarity.

[1] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R1938&from=EN

[2] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010R0994&from=EN

[3] https://www.ceer.eu/documents/104400/-/-/3f0245b9-96dd-f1b2-1cfa-192ad9e6303b

[4] https://www.ceer.eu/documents/104400/-/-/42f8b22e-68f7-d205-5b02-73cda850a676

2 Guidelines

A. Solidarity kicks in when gas is not buyable anymore

CEER highlights in the new regulation that a Member State may only request solidarity when:

i) all measures, including the non-market measures e.g. gas in storage, curtailment plan, etc. in the coordinated emergency plan of the solidarity requesting Member State are exhausted; and

ii) gas suppliers in the solidarity requesting Member State (gas suppliers) cannot find any market offer at any source (from third countries, European hubs, demand-side response (DSR), storage facilities, production, LNG, etc.) to deliver additional[5] gas for the concerned protected customers: the gas market has failed. This means that any trading agreement to procure gas (tenders, auctions, swaps, options, buy-back, etc.) is already used before the stage where solidarity kicks in.

The gas market fails to offer additional gas volumes but the gas network is still able to reallocate and transport gas when solidarity kicks in. When system integrity fails completely due to pressure drops because of drastically shrinking gas flows, there would be a shutdown of the transmission network and consequently gas deliveries. Obviously, solidarity can only be provided while the gas network is still able to safely relocate and transport gas.

Wholesale gas prices will be extremely high when scarcity grows to the point where the market fails to offer additional supplies. When solidarity kicks in, the price signal will have already mobilised additional gas sources as much as possible, including DSR. Obviously, gas is highly valued when solidarity kicks in and this raises the issue of affordability of solidarity.

The scale of the crisis is considerable since it is probable that a number of Member States will face problems to procure sufficient gas volumes. This situation is likely to spread out quickly if no new gas supplies will arrive. Reallocation of remaining gas from non-protected customers to protected customers, this is basically the solidarity mechanism. Solidarity is not a stable solution but a temporary prioritisation. Gas supplies should rapidly be restored to avoid a shutdown of the gas system and an overall crisis in the society.

When solidarity kicks in, gas suppliers in the solidarity requesting Member State cannot find any market offer from any supply source to deliver additional gas for the concerned protected customers. Since all markets within the EU are accessible for sourcing gas for European customers, this means that market-functioning at relevant regional level and even in Europe, depending on the causes of the crisis (e.g. infrastructure failures), has stopped and that the EU is in a phase of forced curtailment to protect supply to protected customers (including critical gas-fired plants as foreseen in the regulation). Therefore, Member States may enter into a situation where remaining gas consumption of non-protected customers is reallocated to protected customers in the country as well as to protected customers in the solidarity requesting Member State.

In the short term, there are no gas trades nor gas procurement anymore and reallocation of the remaining gas is the only option to cover any missing gas for protected customers. Reallocation of gas in case of solidarity, basically releasing gas from non-protected customers to protected customers in the solidarity requesting country, is based on an emergency policy in which the market,

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[5] The problem is the procurement of additional gas volumes beyond the continued deliveries of already contracted gas. There is no market anymore to procure additional gas.

buying and selling of additional gas, is no longer available. This reallocation of gas does not exclude financial compensations but cannot rely on trading contracts anymore. If the latter would still be the case, there would still be a market for procuring gas.

B. No need for new entities to organise solidarity

CEER believes that, where possible, no new entities should be created to organise the reallocation and cross-border transfer of natural gas from a Member State providing solidarity to a Member State requesting solidarity. The TSO (or for example the balancing entity) may be the best entity to deliver solidarity (reallocation and cross-border transfer of gas).

In this scheme the Member State takes overarching responsibility for the implementation of solidarity and entitles the TSO to execute the necessary gas dispatching in a least-cost manner. The Member State remains responsible for the offer, request and - as may be the case - refusal of solidarity as well as the framework for the settlement of compensations. TSOs in the solidarity requesting as well as in the solidarity providing Member States should work together to execute efficiently the agreed solidarity obligations. The coordinated emergency plans should contain the frameworks within which the TSO operates. TSOs will continue to have primary regard to the safe operation of the system.

C. Solidarity gas volumes cannot be predefined

CEER believes that the actual determination of available gas volumes for solidarity as well as the actual determination of compensations can only be computed as soon as solidarity kicks in. This, of course, according to previously agreed procedures in the coordinated emergency plans.

Any kind of contract for gas sourcing in case of an emergency, meaning a predefined volume of gas according to a predefined price or price formula, is a market practice and can, therefore, not be considered within solidarity. All these contracts must be exhausted before solidarity may kick in.

The only way to meet requested solidarity gas volumes is by reallocating the gas. Reallocation by curtailing remaining gas consumption from non-protected customer to protected customers while considering the gas needs for protected customers in the solidarity requesting Member State as well as in the solidarity providing Member State itself according an equal treatment.

The gas volume available for reallocation to meet a solidarity request may only be computed in the moment of the request (e.g. on a day-ahead basis) depending on the remaining gas consumption of, not yet curtailed, non-protected customers. Gas from any other sources is already exhausted and the still gas consuming non-protected customers were not willing to release their gas consumption on a commercial basis (otherwise solidarity would not yet kick in).

D. European gas market is the reference market

CEER considers the handling of national emergency cases within the context of an EU gas market which is accessible for all EU gas suppliers. There can only be a case of market failure if suppliers are not able anymore to find any market offer at any source, within the EU as well as in third countries, to deliver additional gas for the concerned protected customers. This within the constraint of sufficient cross-border transmission capacity, if this constraint would be the case, and as long as this lack of physical capacity is not mitigated by swapping of gas or backhaul.

CEER emphasises the market dynamics in the EU when gas is missing in one of the Member States. In case of growing overall gas scarcity, the demand for alternative gas sources will have an upward push on the gas price in Europe, certainly if the market liquidity is becoming tight. Market clearance (demand=supply) will still be guaranteed but with increasing gas prices. As gas prices increase, dynamics from the supply side as well as the demand side, will maintain market clearance.

Gas demand will significantly be reduced when gas prices increase and gas offers will be as high as possible according to these increased prices. The liquidity in the EU market matters when handling the emergency in one Member State since each Member State has access to this market and gas sourcing as well as the supply portfolio of international gas companies are managed across the Member States.

E. Gas price of last gas trade as reference price for solidarity gas

When solidarity kicks in, the system is in a forced curtailment scheme, otherwise there would still be possibilities to source and trade gas on a commercial basis. CEER believes that in these severe circumstances, if a Member State is requested to provide solidarity, the TSO curtails the necessary gas consumption by non-protected customers in respect of the curtailment plan as specified in the coordinated emergency plan.

The minimum compensation that may be requested should correspond to the market-based gas price of the last gas trade on the virtual trading point (VTP, hub) in the solidarity providing country (reference solidarity gas price). If there are no trades on the gas exchange, for whatever reasons, the gas price of the last traded gas volume should be considered as the reference price. In any case, the reference price should be representative as the market-based price of the last gas trade and this upon scrutiny by the NRA. Transmission costs are on top-off of the gas price and curtailment is depending on the available transmission capacity and the particularities accompanied with the request for solidarity (which routes, profiles, etc.).

This minimal compensation may be increased by Member States if the reference solidarity gas price does not fully cover the economic losses of the non-protected customers (VoLL – value of lost load) from the curtailment.

While the reference price for solidarity is generally known when solidarity kicks in, this is less the case for the VoLL of the curtailed non-protected customers. CEER believes that a study of the VoLL of gas disruptions would be useful to give indicative estimations of the VoLL in the emergency plans and to give indications of the necessary compensations when solidarity is requested and provided. In this scheme, the TSO in the solidarity providing Member State selects the most efficient curtailments, within the framework offered by the emergency plan, to meet the specificities of the solidarity request as much as possible and reallocates gas flows accordingly. By doing so, this could help to exclude possible strategic behaviour from non-protected customers. However, other factors also have to be considered. For example: does the country asking for solidarity send the same request to different neighbouring countries, or will the asking country already split up its demand for additional gas flows and ask each neighbouring country for a certain share?[6]

CEER argues that any gas reallocation scheme for solidarity protected customers should have no additional costs – besides the set up and maintenance costs, such as fixed costs for IT – during normal market functioning. Costs for a solidarity mechanism only occur when solidarity is called. Any costs related to the application of solidarity should reveal during the situation of solidarity itself. Solidarity may not introduce perverse incentives in existing balancing and cash-out regimes. Solidarity measures should not lead to double paying for example. There are various cash-out regimes across Europe and therefore the need for specific implementation to ensure that solidarity works alongside the existing arrangements.

[6] Not every amount of gas will cost the same in terms of which non-protected customers would have to be curtailed. If this sharing of solidarity is not well arranged operationally, strategic behaviour by non-protected customers or Member State may appear.

F. Non-used transmission capacity for solidarity

As previously argued, when solidarity kicks in, the system is in a forced curtailment scheme and gas is reallocated according to the solidarity mechanism. Curtailment and reallocation of gas may happen at the same time for helping solidarity requesting Member States as well as for continuing gas supply in the solidarity providing Member State. The handling of the emergency is beyond the contractual sphere and the Member State takes over the management of the reallocation of flows and entitles the TSO for the necessary efficient dispatching of these flows according to a set of predefined emergency procedures.

CEER suggests that TSOs are entitled to use non-used transmission capacity (e.g. on a day-ahead basis in line with a day-ahead provision of solidarity gas), no matter whether this capacity has been allocated or not, to reallocate gas efficiently within the solidarity scheme. No market rules (e.g. NC CAM) are applicable for transporting these reallocated gas volumes by using non-used transmission capacity. Basically, the Member State will manage the solidarity gas volumes to be reallocated and request the TSO for an efficient and safe dispatching. This practice does, however, not exclude that compensation for gas transmission may be required according predefined principles in the emergency plan which may not deviate from the existing tariff rules.

The reallocation of gas from helping Member States may be limited by the available cross-border capacity. However, overall capacity use is low in case of a crisis (e.g. gas flows to protected customers and curtailment of non-protected customers) and the TSO is well-placed to dispatch gas flows efficiently to meet the solidarity needs (see also swapping of gas volumes). Furthermore, the problem-solving potential of gas release may depend on the location.

The gas supplier of the curtailed non-protected customers is, of course, supposed to continue gas supplies according to the predefined (maximum) profiles in the supply contract with that customer while the TSOs manage the necessary dispatching taking into account solidarity obligations. The gas supplier should be sure of continued payments taking into account solidarity volumes which will be settled within the compensation scheme managed by the concerned Member States.

CEER recommends that depending on the agreements between Member States, which are basically reflected in the coordinated emergency plans, legal and regulatory documents in the Member States should be adapted to clearly specify the legal responsibilities and rights of the stakeholders (TSOs, gas suppliers, gas consumers, etc.) in case of solidarity.

G. Fair compensations to avoid strategic behaviour

According to the regulation, compensations are settled between the involved Member States.

The reallocation of the solidarity gas is coordinated between the Member States concerned and Member States requesting solidarity basically manage the budget that could be spent to pay for solidarity (manage the level of requested solidarity) and may refuse help. The willingness to pay for continuing supply to protected customers remains the outcome of a trade-off to be made by the concerned Member States.

Whether non-protected customers are compensated or not in case of reallocation of gas and the cost-recovery of money spent through the solidarity mechanism are matters of the Member States. A guarantee of a fair compensation of the stakeholders (e.g. gas suppliers which continue to supply gas that is reallocated for solidarity as well as gas consumers, TSO etc.) is important to realize effective gas reallocation for solidarity purposes and to avoid strategic behaviour leading to e.g. an avoidance of being involved in solidarity.

The price of solidarity gas and affordability are certainly issues which may limit the effective use of solidarity. CEER believes that any cost-recovery scheme for money spent on solidarity should not impose a burden on the gas market development in the Member States concerned.

3 Next steps

CEER recommends that the legislation and regulation in Europe, including the network codes (esp. the NC CAM[7]) should be adapted where needed to cover the framework in place for solidarity. The role of the stakeholders (e.g. TSO role in reallocating gas flows, suppliers need to continue supply in case of curtailment of their customers, etc.) must be clearly defined in the legislative and regulatory framework. This according the standard procedures including consultation and with respect of legal competences of the different stakeholders.

[7] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R0984